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IN THE

Supreme Court of the United States

October Term, 1951.

No. .....

GEORGE HERBERGER and MABEL HERBERGER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in the above-entitled matter on March 7, 1952.

Opinions Below.

The memorandum findings of fact and opinion of the Tax Court is reported at 9 T. C. M. 546. The opinion of the Court of Appeals is reported in 195 F. 2d 293.

Jurisdiction.

The judgment of the Court of Appeals was entered on March 7, 1952. [R. 111.] The jurisdiction of this Court is invoked under I. R. C., Section 1141(a), and 28 U. S. C., Section 1254(1).

Questions Presented.

The questions presented in this proceeding are as follows:

1. Whether under the facts and the law of California the transaction between petitioner George Herberger and one Harmel in 1944 was (a) an immediate sale, on credit, of Herberger's entire stock of pickles, or (b) a transaction in which, as each payment was made, there was a sale for cash of an equivalent quantity of pickles at the price agreed upon.

2. Whether petitioners' income was, solely by virtue of certain Treasury regulations, not clearly reflected on a cash basis.

Statutes and Regulations Involved.

The text of the statutes and regulations involved herein are contained in the Appendix, *infra.*

Statement of the Case.

This proceeding involves the federal income tax liability of petitioners for the years 1943 and 1944. Petitioners are husband and wife. They resided in California during the taxable years. The income here involved was all community income. [R. 76.]

Petitioner George Herberger was engaged in the taxable years in the business of processing and selling pickles. [R. 76.] He carried on the processing with no more than one or two temporary helpers and had a trucker attend to deliveries and make collection on delivery. [R. 77.]

Herberger bought his year's supply of cucumbers in July. They were placed in vats and salt was added. The curing in salt required 90 to 120 days. Thereafter quan-

tities of the pickles were placed in smaller tanks and processed for about three days. Herberger could process a total of 42 barrels a week. Herberger sold his pickles in barrels, or in five-gallon jars. [R. 77.]

Herberger bought for cash, not on credit, the cucumbers and other materials and supplies used in his business. [R. 107.] He sold for cash and not on credit. If an invoice was not paid on delivery he kept it in his pocket for a few days until he could collect. [R. 77.]

The method regularly employed in keeping Herberger's books was the cash receipts and disbursements method. His income tax returns and those of his wife, petitioner Mabel Herberger, were made on a cash basis. [R. 107.] He took an inventory at the end of each year. [R. 81.]

On October 31, 1944, one Henry Harmel offered to purchase Herberger's entire inventory of pickles, 1626 barrels, then in the vats at Herberger's processing plant, provided he, Harmel, could have the use of the plant for processing them. [R. 78-79.] An agreement was reached. Herberger turned over to Harmel the keys to the plant and Harmel and his employees processed the pickles there without Herberger's assistance or presence. It was agreed that Harmel should be out by June, 1945, as Herberger expected to buy a new crop in July. Harmel finished the processing in April, 1945. [R. 79.]

The total consideration to be paid by Harmel was $29,-268, computed at $18 per barrel. [R. 79.] The understanding was that pickles would be removed by Harmel from the vats only in proportion to the payments made by him. [R. 61, 65, 83.] He abided by this understanding. [R. 65.] He paid Herberger $10,000 at the time of the agreement, October 31, 1944. He made payments

totaling $14,390 in 1945. As to the balance of $4,878, although petitioners do not concede that this is supported by the record, the Tax Court found that it was paid in 1944. [R. 79.] Herberger took an inventory at the close of 1944, counting as his pickles the proportion not covered by the initial payment of $10,000 in 1944. [R. 83.]

The Commissioner in arriving at the deficiencies which he asserted:

(1) treated this deal with Harmel as an immediate sale, on credit, of the entire stock of pickles in 1944; and

(2) included the deal in its entirety in petitioners' 1944 income on the ground that, by virtue of specified Treasury regulations, petitioners' income was not clearly reflected on a cash basis.

It is these two actions of the Commissioner which present the two issues raised here. The Tax Court sustained the Commissioner on both. The court below affirmed. It is obvious that if the Tax Court was wrong on either issue, there is no need to decide the other.

Specification of Errors to Be Urged.

Petitioners specify the following errors of the Court of Appeals for the Ninth Circuit:

1. Failure to hold that the transaction with Harmel in 1944 was one in which, as each payment was made, there was a sale for cash of an equivalent quantity of the pickles at the price agreed upon.

2. Holding, solely on the basis of certain Treasury regulations, that petitioners' income was not clearly reflected on a cash basis.

REASONS FOR GRANTING THE WRIT.

I.

The Decision of the Court Below Upholding the Tax Court's Conclusion That the Deal With Harmel in 1944 Was an Immediate Sale, on Credit, of Herberger's Entire Stock of Pickles, Is in Conflict With the Settled Law of California, the State in Which the Contract Was Made and Carried Out.

The question whether or not the deal with Harmel in 1944 was an immediate sale, on credit, of Herberger's entire stock of pickles—involving, as it does, the respective rights of the parties in the goods and against each other which ensued from the transaction—is a question governed by local law.

Poe v. Seaborn, 282 U. S. 101, 110;

Freuler v. Helvering, 291 U. S. 35, 45;

Blair v. Commissioner, 300 U. S. 5, 9-10.

When the agreement with Harmel was made, in 1944, the pickels remained in Herberger's vats. Harmel could take them out only as he paid Herberger for them. Herberger took an inventory at the close of the year, counting as his the pickles not paid for, thereby treating the transaction not as a sale on credit, but as one in which, as each payment was made, there was a sale for cash of an equivalent quantity of the pickles at the price agreed upon.

The Tax Court here contended, however (1) that possession of the pickles was transferred to Harmel at the time the agreement was made, and (2) that therefore title passed to Harmel at that time. The court explained the fact that Harmel could not take the pickles out of the vats in advance of having paid Herberger for them by saying

that what Herberger retained in respect to the pickles not paid for was a vendor's lien. [R. 83.] That theory, however, defeats the Tax Court's own conclusion. *A vendor's lien depends upon the continuance of possession by the vendor.* The California Civil Code, Section 1776, provides:

"(1) The unpaid seller of goods loses his lien thereon:

* * * * * * * *

"(b) When the buyer or his agent lawfully obtains possession of the goods;".

In *Hougham v. Rowland,* 33 Cal. App. 2d 11, 90 P. 2d 860 (1939), the court discussed the law of vendor's liens, and said (p. 15):

> "In the above-cited case (*Eads v. Kessler,* 121 Cal. 244, 53 P. 656) the Court quotes section 119 of Tiedman on Sales, as follows: 'In order that a vendor of goods may claim a lien on the goods, they must have already become the property of the vendee, for one cannot have a lien on goods belonging to himself . . . The only cases in which the vendor can have a lien on the goods are those in which the title to the goods passes to the vendee without delivery or *possession.*'" (Italics added.)

It follows that if Harmel did have possession, then Herberger had no vendor's lien. But if Herberger had no vendor's lien, his rights in respect to the goods not paid for could only be explained as ownership. On the other hand, if Harmel did not have possession, the sole basis of the Tax Court's conclusion that title passed to him when the agreement was made disappears. It must follow that Herberger remained the owner of the goods not paid for.

It must follow also that Herberger correctly treated the transaction not as a sale on credit but as one in which, as each payment was made, there was a sale for cash of an equivalent quantity of pickles at the price agreed upon. (Williston on Sales, Revised Edition, Sec. 466a; 22 Cal. Jur. 920, citing *Helms v. Pacific Mill & Timber Co.*, 57 Cal. App. 442, 207 Pac. 708; *Veerkamp v. Hayward C. & D. Co.*, 58 Cal. 229, 41 Am. Rep. 265; *United Canneries Co. v. Seeyle*, 48 Cal. App. 747, 192 Pac. 341.) The decision of the court below in upholding the Tax Court's conclusion that the deal with Harmel in 1944 was an immediate sale, on credit, of Herberger's entire stock of pickles, is in clear conflict with the settled law of California, the state in which the contract was made and carried out.

II.

The Decision of the Court Below That, by Virtue Alone of Certain Treasury Regulations, the Income of Petitioners Was Not Clearly Reflected on a Cash Basis, Is Directly Contrary to Decisions of Courts of Appeals of Other Circuits.

The Internal Revenue Code provides, in Section 41, that the net income "shall be computed . . . in accordance with the method of accounting regularly employed in keeping the books." Only "if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income," may any other method be used. (*Infra*, Appendix, p. 1.) The petitioners here regularly kept their books in accordance with the cash method. The cash method was therefore *mandatory* for them, unless it appears that by the cash method their income was not clearly reflected. The precise question presented therefore

is whether the cash method did or did not clearly reflect petitioners' income.

The reasons given by the court below in answering that question in the negative may be summarized in syllogistic form as follows:

(1) In every case in which the production, purchase or sale of merchandise is an income-producing factor, it is provided under Treasury Regulations 111, Secs. 29.22(c)-1 and 29.41-3(1),[1] that inventories at the beginning and end of each year are necessary in order correctly to reflect the income.

(2) Where inventories are necessary, it is provided under Treasury Regulations 111, Sec. 29.41-2,[2] that no method of accounting will correctly reflect income except an accrual method.

(3) Therefore, in every case in which the production, purchase or sale of merchandise is an income-producing factor, no method of accounting will correctly reflect income except an accrual method.

(4) In petitioners' business, the purchase and sale of merchandise were income-producing factors.

(5) Therefore, in petitioners' business no method of accounting will clearly[3] reflect the income except an accrual method. [R. 109-110.]

There is no contention by the court below, nor by the Tax Court, that the cash basis did not, in fact, clearly

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[1]For the text of these regulations see *infra*, Appendix, pp. 1 and 2.

[2]For the text of this regulation, see *infra*, Appendix, p. 2.

[3]The statute uses the word "clearly" only. The regulations use the word "clearly," and appear also to use the word "correctly" to mean the same thing.

reflect petitioners' income. Nor did the Tax Court find that the Commissioner had so determined. Nor could the Commissioner have so determined. Whether the transaction with Harmel is treated as an immediate sale, on credit, of the entire stock of pickles, or, as Herberger treated it, as a sale for cash, as each payment was made, of an equivalent quantity of the pickles at the price agreed upon, in either case the profit is precisely accounted for.[4] It is on the Treasury regulations alone that the conclusions below were based.

The regulations involved are not of recent origin. They go back, in fact, to the Revenue Act of 1918. Regulations 45, Art. 1581, as amended by T. D. 3286, I-1 C. B. 40 (1922); Regulations 45, Art. 23(1), as amended by T. D. 2873, 1 C. B. 58 (1919). It is remarkable, however, that in all that time, prior to the present proceeding, a matter of approximately thirty years, there was not a single ruling or decision applying these regulations. The only decisions relating to the precise problem were directly contrary to the regulations.

In *Mann v. Commissioner* (App., D. C.), 35 F. 2d 873 (1929), affirming 8 B. T. A. 221, the taxpayer was, *inter alia*, in the merchandising business. He kept his books on a cash basis and filed his returns on that basis. He took inventories at the beginning and end of each year and used them in computing his profit. Before the Board of Tax Appeals he sought an allowance on an accrual basis for certain deduction items not paid during the taxable

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[4]In a substantial sense only the cash basis could clearly reflect the income here; for the use of Herberger's plant by Harmel was an essential element of the transaction, and that use extended throughout the period of payments.

year. The Board denied the allowance because his books were kept on a cash basis. The Court of Appeals for the District of Columbia affirmed.

In *Glenn v. Kentucky Color and Chemical Company, Inc.* (C. A. 6), 186 F. 2d 975 (1951), the taxpayer, a manufacturer, kept its books and made its returns on a cash basis. It took inventories at the beginning and end of each year and used them in computing its profit. The government contended that the taxpayer's income should be recomputed on an accrual basis. The Court of Appeals for the Sixth Circuit rejected the government's contention. It directly considered the regulations here involved and held (a) that they were not mandatory, and (b) that if they were mandatory there would be serious doubt of their validity.

It is helpful to note that the two cases outlined above were not both decisions in favor of the taxpayer. While in the *Glenn* case it was the taxpayer which contended for the cash basis, the basis on which the books were kept, in the *Mann* case it was the government which contended for that basis and was similarly sustained.

It is also helpful to note that the Treasury regulations involved here, which were in effect discredited in the *Mann* and *Glenn* cases, *supra,* are inconsistent with other Treasury regulations. In Regulations 105, sec. 29.22(a)-7, it is provided that a farmer producing and selling "livestock and produce," or buying and selling "livestock or other items," need not take inventories and may report his income on a cash basis. (*Infra,* Appendix, p. 1.) That

provision, too, has been in the regulations since the Revenue Act of 1918. (Reg. 45, Art. 38.) Apparently, then, the regulations which the court below has applied here, under which, "in order to reflect the net income correctly," inventories, and because of inventories the accrual method, are necessary "in *every* case in which the production, purchase or sale of merchandise is an income-producing factor," do not apply to farmers. Yet there is nothing in the statute which exempts farmers from using such method of accounting as clearly reflects their income. The farmer as well as the picklemaker must clearly reflect his income. The regulations as a result are definitely inconsistent.

The court below made no attempt to distinguish the *Mann* and *Glenn* cases. It, indeed, recognized the likelihood that those cases were in conflict with its decision herein; for it stated that "if and to the extent" the *Mann* and *Glenn* cases supported petitioners' contention, it regarded them as erroneous and declined to follow them.[5] [R. 111.] As the analysis of those two cases above shows, the decision below is in clear and direct conflict with them.

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[5]The third case mentioned in the opinion below, *Beckman v. Commissioner*, 8 B. T. A. 830 (1927), while only a Board of Tax Appeals case, is noteworthy in the fact that, as in the *Mann* case, it was the government which contended for the cash basis and was sustained. In the *Beckman* case, the Board, in support of the government, flatly stated: "The fact that inventories were taken at the beginning and close of each year is not sufficient in itself to show that the cash receipts and disbursements method did not clearly reflect income."

III.

The Decision of the Court Below in Basing a Determination as to Accounting Method on a Single Transaction Is in Conflict With Decisions of This Court.

The Tax Court made it clear that nothing was involved here except the deal made with Harmel in 1944. As to the few small invoices which Herberger carried in his pocket for a day or two before he collected them, the Tax Court expressly conceded that there was "no very material difference in the result, tax-wise." [R. 82.] In view of that fact it is not understandable why the court below referred again and again to the amounts of these small items—totaling $171.40 at the end of 1942, and $946.86 at the end of 1943—as if they were on a par with the amount involved in the deal with Harmel.[6] Clearly, it is only the deal with Harmel which is involved here.

A taxpayer's accounting method, however, cannot be predicated on a single transaction. If, disregarding a single transaction, the books clearly reflect the income, the single transaction must be adjusted to the method by which the books are kept and not *vice versa.* (*Security Flour Mills Co. v. Commissioner,* 321 U. S. 281, 285.)

The decision of the court below in basing a determination as to accounting method on a single transaction is thus in conflict with decisions of this court.

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[6]The court below was in error in stating [R. 109] that petitioners made any contention, one way or the other, in regard to the two amounts of $171.40 and $946.86 referred to above. As a quick computation from the record will show, adjusting those two amounts alone to an accrual basis would have meant a slight reduction in tax.

IV.

The Decision of the Court Below Should Be Reviewed Here Because of Its Importance; More Than 200,000 Taxpayers Are in Precisely the Same Position as Petitioners Here, and Will Be Affected in the Same Manner by the Result in This Proceeding.

The only available statistics as to the number of taxpayers using particular accounting methods in specified industries are those published by respondent under the title "Statistics of Income." The latest figures so reported are for 1946. In Part 2, pages 15-16, of the issue for that year it is shown that of corporations engaged in manufacturing and trade, excluding those operating on a commission basis, 33,169, or approximately 13 per cent of the total, made their returns according to the cash method. Most of these corporations were, indeed, small corporations, as the figures on page 17 of the same issue indirectly indicate.

There are no similar published data on partnerships and individuals. However, there are more than a million and half individuals engaged in manufacturing and trade. "Statistics of Income," 1945, Part 1, page 194. Obviously they are smaller than corporations and should therefore contain a higher percentage of taxpayers on a cash basis. But if only the same percentage were on a cash basis, that would be over 195,000. We suggest the likelihood that respondent has and could submit the precise figure.

Clear it is, in any event, that more than 200,000 taxpayers, not counting farmers, are engaged in a business in

which "the production, purchase, or sale of merchandise is an income-producing factor," but keep their books and make their returns on a cash basis. More than 200,000 taxpayers are therefore in precisely the same position as petitioners here and will be affected in the same manner by the result in this proceeding. For that reason alone, we submit, the decision of the court below should be reviewed by this court.

Conclusion.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

GEORGE T. ALTMAN,
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